

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-670

February 20, 1998

MAINE PUBLIC SERVICE COMPANY
Divestiture of Generation Assets

ORDER

WELCH, Chairman, NUGENT and HUNT, Commissioners

I. SUMMARY

We approve Maine Public Service Company's (MPS or the Company) plan to divest the Company's generation assets. We do not modify MPS's plan to sell its assets to the highest bidder, because the bid process is reasonable and MPS may reject the bids for any or all of the generation assets. In evaluating bids, MPS should consider the risks and benefits associated with selling its Tinker Generating Station and the market power concerns described in this Order.

II. BACKGROUND AND PROCEDURAL HISTORY

The MPS electrical system is strengthened by interconnections with New Brunswick, Canada, which allow electrical support from the New Brunswick Power Corporation (NB Power). However, unlike Central Maine Power Company (CMP) and Bangor Hydro-Electric Company (Bangor Hydro), MPS is electrically isolated from the area controlled by the Independent System Operator-New England (ISO-NE) and must move power through NB Power and Maine Electric Power Company (MEPCO) to transact within ISO-NE. The transmission capacity between MPS and NB Power is 200 MW when all lines are in service and 72 MW if a line is out of service. From an economic perspective, the ability to sell across New Brunswick is further limited because, while NB Power does have open transmission access, access is obtained at relatively high transmission rates.

All MPS transactions into the area controlled by ISO-NE are wheeled through New Brunswick and then over the MEPCO transmission line. According to MPS, the Company could deliver as much as 100 MW or as little as 0 MW to ISO-NE, depending upon the status of generating units and transmission lines in Canada. For stability purposes, sales north to south have historically been required to enable MPS to make purchases from the south. However, there are severe limitations on the ability to import power from the area controlled by ISO-NE into MPS's territory

because of constraints on the MEPCO line. Given the cessation of stability flows in 1997, firm power cannot now be purchased from the south. Non-firm power can be purchased when other factors that affect the MEPCO line, such as load in New England, generation in Maine and other flows on the MEPCO line, allow.

With the passage of "An Act to Restructure the State's Electric Industry" (the Restructuring Act), MPS is required, with certain exceptions, to divest all generation assets and all generation-related business activities by March 1, 2000. P.L. 1997, c. 316 *enacting* 35-A M.R.S.A. § 3204(1). The Restructuring Act requires the divestiture to be accomplished according to a plan submitted to the Commission for review. The divestiture of generation assets is important both to ensure effective competition and to value generation assets for purposes of measuring stranded costs.

On September 9, 1997, MPS filed its plan to divest its generation assets. Under its plan, MPS is offering to sell its generation assets and power entitlements to an unaffiliated buyer for cash consideration. MPS has begun soliciting bids and expects to complete the process by April 10, 1998. MPS has hired Stone and Webster Management Consultants, Inc. to assist the Company in its sale efforts. Stone and Webster was selected because of its experience with generating sale activities in New England and California, as well as its familiarity with the Company.

MPS has a total of 109.8 MW of generation resources including 35.8 MW of hydro-electric and 55.9 MW of thermal resources. The specific assets offered for sale are:

- Millinocket Lake Storage Dam;
- Squa Pan Dam, including storage and 1.4 MW of hydro-electric generating capacity;
- Caribou Generating Station, consisting of 23.0 MW of oil fired steam capacity, 7.0 MW of diesel capacity and 0.9 MW of hydro-electric capacity;
- 4.2 MW of diesel power at Flo's Inn Generating Station and a dismantled diesel unit at Houlton Generating Station;
- A 3.3455% interest, equivalent to 20.7 MW, in the Wyman Unit No. 4 oil fired thermal plant in Yarmouth, Maine;

- Rights to the output of a 18.1 MW biomass plant currently under a purchased power agreement between Wheelabrator-Sherman Energy Company (Wheelabrator Sherman or W/S) and MPS;
- 34.5 MW Tinker Station, which includes 33.5 MW of hydro-electric capacity and 1 MW of diesel capacity.

The Tinker Station is located on the Aroostook River in Aroostook Junction, New Brunswick, across the border from Fort Fairfield, Maine. The Tinker Station is owned and operated by a wholly-owned subsidiary of MPS, Maine and New Brunswick Electrical Power Company, LTD. The properties of MPS and the subsidiary are operated as a single integrated system. The subsidiary sells to MPS the energy not needed to supply the subsidiary's wholesale New Brunswick customer, the Town of Perth-Andover. The Perth-Andover contract is a full requirements contract. The contract term is through December 31, 2004, and is automatically renewed every 5 years unless and until either party gives the other written notice to terminate the contract. The Perth-Andover sales for 1996 were 29,551 MWH with a peak load of 8.4 MW. The subsidiary also owns transmission assets connecting the Tinker Station to the MPS service territory and an interconnection with NB Power. The Tinker Station is being offered in three options:

- purchase 100% ownership of the subsidiary, including the generation, transmission and other assets;
- purchase only the generation assets, the Tinker Generating Station;
- purchase only the rights to the output of the Tinker Station.

The Company states that its goal in selling its assets is to maximize the sale price and thereby reduce the Company's stranded costs. The Company is using a public bidding process to solicit bids from a large number of potential bidders, both in the United States and Canada. Its first step was to issue a "teaser" letter. Interested bidders were then sent an offering memorandum which describes in more detail the generation assets being sold and the transaction process. Bidders were invited to a data room to inspect the Company's records on its generating assets and to inspect the generating plants and storage dams. By October 27, 1997, bidders were required to submit a non-binding statement of qualifications indicating their capabilities to operate and maintain the generating assets and to consummate the transaction. On November 10, 1997, MPS notified qualified bidders to commence

their due diligence activities with binding bids being due on January 15, 1998. Qualified bidders were determined based on their financial and technical qualifications. MPS intends to complete negotiations with the bidders by April 10, 1998. The Company intends to select the bid or combination of bids that maximizes sale revenue and minimizes stranded cost resulting from the divestiture. Bidders have the option of offering the sale of the output of the sold plants back to MPS through February 29, 2000.

Timely petitions to intervene were filed on behalf of the Public Advocate and Wheelabrator-Sherman. Late filed petitions to intervene were filed on behalf of Tractebel Energy Marketing, Inc. and the Industrial Energy Consumer Group (IECG). All petitions to intervene were granted. A hearing and oral argument was held on December 18, 1997, in which the testimony of Company witnesses Fred Bustard, David Holabird and Timothy Brown was heard. Mr. Bustard explained that the Company had recently contracted for replacement energy and capacity with two entities, Alternative Energy, Inc. (AEI)¹ and Hydro-Quebec (HQ). The contract with AEI provides MPS with the ability to meet its load requirements in excess of the amount served by the combined output of the Tinker Station and the Wheelabrator-Sherman contract. The Hydro-Quebec contract allows the actual amount of power delivered to vary widely, up to 130MW. MPS has also entered into a marketing agreement with Cinergy Corporation of Ohio whereby Cinergy will market surplus energy acquired by MPS under the Hydro-Quebec and AEI contracts. By taking up to the maximum output pursuant to the Hydro-Quebec contract, MPS could fully replace the output associated with the generating assets presently for sale.

III. REVIEW OF MPS'S PLAN

MPS's divestiture plan is adequate, consistent with the Restructuring Act and reasonable on its face.² In general, MPS's divestiture plan bears a strong resemblance to the plans developed by other utilities in New England including New England

¹ AEI owns a 37 MW generation facility in Ashland, Maine.

² The Commission has relied, in part, on the report by Econsult Corp., the Commission's consultant in this proceeding, to identify issues we are likely to address in the next phase. The Commission considers that report to be a sound articulation of the issues that the Commission should consider. Except to the extent stated in this Order, however, the Commission neither endorses nor disputes any of the conclusions set forth in that report. We attach a redacted copy of the consultant's report to this Order.

Electric System (NEES), Boston Edison, Eastern Utilities Associates, and Central Maine Power Company.

A. Plan Development and Design

Overall, the components of MPS's plan, including the offering memorandum, information distribution and scheduling, are adequate. Principal elements of the asset divestiture process include selection of an advisor, development of a marketing strategy, packaging the assets and formulating a bid procedure, advertising or marketing to potential purchasers, and comparison of other divestiture options.

MPS began its process with the selection of Stone and Webster as its advisor. Unlike other companies such as CMP and NEES, MPS did not retain an investment banker. Given the small size of MPS's assets, the similarity of MPS's plan as compared to other companies, and the importance of transmission constraints in evaluating its assets, MPS's decision to proceed without an investment banking firm is reasonable.

MPS used a single bid process. The interest-building component of MPS's plan began with a series of public announcements about the sale. MPS developed a list of potential bidders it believed had genuine interest in the assets and contacted them. The targeted bidders were also advised that an offering memorandum and a document center were available.

With the possible exception of omitting details regarding the status and provisions of the Wheelabrator-Sherman contract, MPS's Offering Memorandum contains information that is adequate for potential bidders to make a decision regarding the seriousness of their interest in MPS's assets. The data are complete and presented in an objective manner, emphasizing the strengths of the asset offerings but disclosing relevant information concerning potential weaknesses. The additional information resources made available also appear consistent with industry practice. The availability of MPS's information room and due diligence opportunities are clearly disclosed and are subject to reasonable confidentiality restrictions. MPS's proposed time frame is consistent with the periods within which the sale processes of CMP, NEES and Boston Edison were completed.

MPS's one-bid sale process is adequate in light of the size of the MPS asset portfolio. MPS granted an extension at the request of one party so that binding proposals were due January 15, 1998 instead of December 8, 1997. MPS's delay in the process to accommodate additional bidding is reasonable to take advantage of opportunities to maximize value for ratepayers.

Based on statements in the oral argument, MPS appears to have been successful in soliciting bidders from other New England sale processes as well as potential Canadian purchasers. Coupled with the extensive publicity that accompanied the mandated divestitures in New England, most potential bidders were likely aware of the proposed asset sales. MPS did not discuss the option of an asset-by-asset auction as an alternative strategy in selling its generating assets. Like CMP, MPS bundled its generation assets into packages defined by type of facility. All facilities of a given type -- fossil, hydro, and power purchase agreements -- are offered as a group.³ However, because MPS's assets are small both in number and aggregate capacity, its bundling is almost equivalent to an asset-by-asset sale.

As to other means for divestiture, MPS addressed the possibility of a generation subsidiary spin-off during oral argument. Counsel for MPS stated that a spin-off would not be beneficial because of high transaction costs, market perceptions of value and environmental issues. We agree that transactions costs for an entity the size of MPS would likely be disproportionate and render the option uneconomic. Consequently we do not address the other reason cited by MPS for rejecting a spin-off.

B. Timing of the Sale of Generating Assets

MPS has proposed to proceed immediately with implementation of its plan for selling its generation assets. MPS has proposed a schedule that will allow it to complete its divestiture transactions before the end of 1998. From ratepayers' perspective, timing issues are different for the various MPS generation assets.

1. Wyman

Timing issues for Wyman involve ensuring that MPS has the option to sell its share of Wyman as part of CMP's divestiture of its Wyman ownership. Therefore timing of MPS's sale of Wyman depends upon the CMP process. Given that CMP is going forward now, MPS's desire to sell Wyman during a similar time frame is reasonable.

2. Aroostook County Fossil and Hydro Plants

Timing issues associated with the plants physically located in Aroostook County are not significant from a ratepayer perspective because these plants produced only 1% of

³ The Tinker Hydro-Electric Station includes 1 MW of diesel generation.

MPS's energy in 1996. All MPS-owned fossil and hydro plants physically located in Aroostook County are small and old. Pursuant to statute, MPS must divest these plants prior to March 1, 2000. For these assets, a sale in 1998 rather than 2000 would not have a significant impact on MPS's stranded costs or on the development of competitive markets.

3. Tinker

The Restructuring Act does not require that MPS divest the Tinker Station, because Tinker is located outside of the United States. The Act does require MPS to sell at least its entitlement to the output of Tinker after February 28, 2000, in accordance with Commission rules.⁴ In recognition of this exception, MPS has offered potential buyers three options for Tinker: (1) purchase of its subsidiary, Maine and New Brunswick Electrical Power Company, Ltd, which includes Tinker Station generating assets, as well as transmission assets; (2) purchase of the Tinker Station generating assets only; and (3) purchase of the output of the station for a period selected by the bidder. Thus, MPS has retained sufficient flexibility to sell the physical assets if a high enough bid is received. If MPS does not receive a sufficiently attractive bid, it could sell the entitlement to Tinker capacity and energy for a relatively short time period, and then either rebid this entitlement or sell the physical assets.

A final sale of MPS's Tinker assets now could limit flexibility in the event retail markets do not develop in MPS's territory. As discussed further in this Order, the market structure and likely market conditions of MPS's territory will be different, and may be constrained, relative to territories in NEPOOL. Moreover, a final sale of the Tinker assets now would lock in the associated market value and stranded cost and expose MPS's ratepayers to the risk of market prices rising.

In any subsequent case in which MPS seeks our approval for a sale of Tinker, we will consider the following questions:

1. Would a delay in the sale of the Tinker Station assets likely benefit ratepayers through realization of a higher sales price once retail markets develop in Canada?
2. Should Tinker Station be used as a hedge for ratepayers, by selling only entitlements to its output for relatively short time periods to

⁴ See 35-A M.R.S.A. § 3204(1)(c) and § 3204(4).

protect against the contingency that competitive markets do not develop in northern Maine because of its electric isolation?

3. Should any final decision on the disposition of Tinker Station be delayed until the Commission has completed its study involving transmission capacity to northern Maine and the efficacy of competitive markets in the region?

We expect MPS to consider these issues as it proceeds and address each in any subsequent filing for sale approval. We discuss each issue in more detail below.

a. Delay selling Tinker assets

Unlike plants in the area controlled by ISO-NE (such as Wyman) where deregulated markets will soon develop and where retail demand will exist for energy and capacity produced by the plant, the sale market for Tinker's output is uncertain. Unless a high price can be realized for Tinker, ratepayers may be better off if MPS sells entitlement to the output for a relatively short-term period, and sells the physical assets at a later date when markets are more developed, or more certain.

At present, energy sales from the Tinker Station into the emerging markets in the area controlled by ISO-NE would be constrained by both physical and economic, or institutional, factors. The physical constraints are the limits discussed earlier regarding flows over the MEPCO line. Economic or institutional factors arise because the plant is outside of the area controlled by ISO-NE and its cost must include an adder for transmission that competing plants located in ISO-NE do not.

If the most likely markets for the output of Tinker are the markets in Canada and Aroostook County, the size of the retail market and the effect of transmission costs may depress Tinker's value. Selling into Canadian markets from Tinker primarily involves constraints related to development of retail markets, as well as high transmission rates. At present, Tinker cannot be sold into retail markets in Canada by any supplier except an existing Canadian utility. According to MPS, retail access in Atlantic Canada is a minimum of five years away. Therefore, if Tinker's output is sold in Canada by any entity not a Canadian utility, it would be only into wholesale markets. Further, there may be market limitations even at the wholesale level because of high transmission rates across New Brunswick. Currently, NB Power's transmission rate is \$40/KW/year.

Transmission costs at such a high level could make it difficult for Tinker to compete in Canadian wholesale markets.

NB Power itself could be a potential market for the Tinker power on a wholesale basis. However, a review of 1996 data demonstrates that this may not be a very attractive option. MPS sold 19,743 MWh to NB Power at an average price of only \$11.40/MWh. Even if this price primarily represented surplus off-peak energy, the price is low compared to NEPOOL prices for similar energy.

The final option for Tinker output is northern Maine, comprising primarily MPS's service territory. MPS must continue to supply the capacity and energy needs of its customers prior to retail access and, after retail access, deliver electricity to its current customers as direct retail purchasers. Prior to March, 2000, sales opportunities into northern Maine could be limited because of the surplus resulting from MPS's contracts with Hydro-Quebec and AEI. Without any significant market in northern Maine for Tinker, particularly in the near term, its full value might not be realized by a sale at this time.

b. Use of Tinker as a ratepayer hedge

Unlike the situation in the CMP divestiture, where its customers and assets will be part of the ISO-NE market, the development of functional competitive markets is less certain in northern Maine. Given this uncertainty, it is possible that ratepayers would benefit if MPS proceeded cautiously, selling Tinker entitlements for relatively short periods rather than selling the assets now. This would allow a future evaluation of how actual markets are operating in the region. If markets are not functioning in an effectively competitive manner, Tinker would remain available to MPS ratepayers.

If competitive markets do not develop in northern Maine, MPS ratepayers could face a situation whereby potential suppliers (then unregulated) possessed market power. As discussed previously in this Order, such factors as severe transmission constraints and economic and institutional barriers indicate the market conditions for customers in northern Maine may be different and, perhaps, less advantageous than for customers in other parts of the State. MPS and the consumer-owned utilities in northern Maine are a small part of a market over which Maine has incomplete control.⁵ Proceeding

⁵ The northern Maine area is mainly Aroostook County. The relevant market includes northern Maine and parts of Canada. The Maine portion of this market is roughly one and one-half times

cautiously in implementing the policies embodied in the Restructuring Act, such as to delay final sale of the Tinker assets, could provide a hedge for ratepayers while a competitive market develops in the region. Once it is clear that the market is functioning with competitive prices available to ratepayers in northern Maine, Tinker could be divested.

We have not concluded at this point that MPS should delay sale of the Tinker assets. At such time MPS proposes to divest Tinker we will address the question of whether the timing and form of its proposed divestiture maximize Tinker's value and adequately protect MPS's ratepayers from the risks discussed herein.

c. Sale of Tinker before the market power study and the northern Maine transmission study

Divesting the Tinker Station assets now could also limit the Commission's flexibility to fashion solutions to issues which might arise in the market power study and northern Maine market viability study, both of which the Commission is currently conducting at the direction of the Legislature.⁶ Selling the Tinker assets now would foreclose a significant opportunity for adjustments in policy or implementation with respect to retail competition for the portions of Maine that are not part of the area controlled by ISO-NE.

C. MPS's Proposed Sale of Wheelabrator-Sherman Capacity and Energy

The Restructuring Act directs investor-owned utilities in Maine to sell their entitlements to capacity and energy from power contracts as of March 1, 2000. For MPS, this means it must sell its entitlement to capacity and energy from the Wheelabrator-Sherman facility. Although not required by statute, MPS has included this sale as part of its divestiture plan at issue in this proceeding. As part of its divestiture process, MPS has requested bids on W/S and asked bidders to propose the purchase term.

We addressed this issue generally in our Order approving CMP's divestiture plan issued January 14, 1998 in Docket No. 97-523. As we stated in that case, selling the output of purchased power contracts through their term, or for long

MPS's load, and includes MPS, Eastern Maine Electric Cooperative, Houlton Water Company (Electric Department), and Van Buren Light & Power District.

⁶ See 35-A M.R.S.A. § 3206 and P.L. 1997, ch. 447.

periods at a time, represents a risk to ratepayers. In contrast, a short term sale coupled with subsequent re-bids provides a hedge to ratepayers against increasing market prices as well as problems, perhaps unique to MPS and the northern Maine COUs, with market development. Short-term bids for the W/S output may also be affected less than longer term bids would be by uncertainty arising from Wheelabrator-Sherman's ability to close the plant at its sole discretion.⁷ We also note a concern about a sale of W/S output during the pre-March 1, 2000 period due to the presence of MPS's purchase contract with HQ. During the pendency of the HQ contract, it is difficult to see any advantage to such a sale. Specifically, if a purchaser bids a price less than the HQ effective price, MPS would be better off not selling but retaining W/S and reducing HQ purchases. On the other hand, no bidder would rationally bid more than the HQ price because it would likely have to resell the power at prevailing market prices, which as discussed in the attached consultant's report, will be driven by the HQ contract.

As in our decision approving CMP's divestiture plan, these concerns do not cause us to reject MPS's plan. However, MPS should be cognizant of these issues as it goes forward. At the time MPS proposes to sell its entitlement to W/S capacity and energy, we will evaluate whether the form and timing of its proposed sale is reasonable.

D. Market Power

1. Generation Market

In our approval of the CMP divestiture plan, we concluded that a sale of generating assets that results in opportunities for the exercise of market power would be contrary to the goals of the Restructuring Act. However, we also concluded that concern that the ultimate sale may result in market power is not grounds to reject the divestiture plan. We reach the same conclusion for MPS's divestiture plan. We express again our serious concern that the sale of utility assets not result in concentration of market power to the detriment of Maine consumers. We will closely scrutinize any proposed asset sale MPS presents to ensure such concentration does not arise or is not significantly worsened by the manner in which Maine's generation assets are divested.

⁷ The revised Agreement between MPS and W-S would allow W-S to suspend its performance under the Agreement upon 30 days notice. This Agreement was recently approved by the Commission in Docket 97-727. Approval of the Finance Authority of Maine is pending.

The factors that define MPS's market structure and the issues relevant to market power are different for MPS than for CMP. Market structure is initially defined by the physical characteristics of available generation and transmission. We described the constraints that affect the import and export of power between ISO-NE and the New Brunswick-northern Maine region above. Although there is adequate transmission capacity across the MPS-New Brunswick interconnection to serve most (if not all) of the load requirements of northern Maine from supply outside the region, constraints on the MEPCO line and economic and institutional factors, primarily in New Brunswick, effectively render northern Maine a distinct market area for purposes of market power analysis.

The relevant market is further defined by the number and size of the competitors in that market. Although Nova Scotia Power Corporation and Hydro-Quebec can physically deliver power to northern Maine, NB Power's relatively high transmission rates and its apparent ability to increase those rates unilaterally make the long term participation of those two entities in the northern Maine market uncertain. The other competing suppliers are NB Power, the future owner(s) of the assets and contracts now owned by MPS, the owner of Aroostook Valley Electric Company (AVEC), and AEI. Competitors on the Canadian side of the interface can physically deliver up to 200 MW of power to MPS's territory, i.e. the tie limit. Competitors on the Maine side can each offer lesser amounts.

Given the size of NB Power's resources in this market, together with its control of the gateway, there are market power concerns that go beyond what the Commission could affect in the context of MPS's divestiture. Nonetheless, the divestiture may present us with a unique opportunity to ensure that an already high market concentration go no higher. In addition, MPS's divestiture presents us with an opportunity to examine whether strategies to decrease the concentration, such as by splitting up MPS's assets among more than one buyer, would be beneficial.

In a market as small as the one considered here, even small changes in market concentration, especially accretions to market share by one of only a few market participants, may be significant. Thus, sale of one or more of MPS's assets to a participant currently in-market could make an already highly concentrated market significantly more so. A sale of all MPS's assets or entitlements to a single buyer not currently in-market would simply perpetuate the existing level of market concentration. A sale of the principal MPS supply entitlements (the Tinker and Wheelabrator-Sherman contracts) to separate

entities not currently in market could increase the number of suppliers and lessen concentration in the market.

2. Renewables Market

The Act requires that 30% of the supply resources for each competitive provider be derived from renewable sources. This requirement effectively defines a separate product market for renewables. Because the structure of the renewables market is unclear at this point, we discuss market power in a renewables market defined similarly to MPS's generation market, and one that also includes the area controlled by ISO-NE.

MPS currently controls a significant portion of the available renewable supply in northern Maine. If the renewable market is defined by supply in northern Maine, sale of all of MPS's renewable assets in one bundle would simply transfer this market share to the buyer. If the relevant market for renewables is broader, including other New England and Canadian suppliers, our concern will be whether a proposed purchase of one or more of MPS's renewable assets would cause an unacceptable increase in market concentration. This could occur if, for example, a current in-market participant with an already large share of the renewable supply proposed to purchase MPS's renewable assets, or W/S's output. We will examine market power in the renewables market at the time MPS proposes to sell one or more renewable asset or contract.

IV. CONCLUSION

MPS's divestiture plan is approved. MPS shall proceed to divest its generation assets in accordance with this plan, and in a manner that addresses the concerns raised by the Commission in this Order.

Dated at Augusta, Maine, this 20th day of February, 1998.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: WELCH
NUGENT
HUNT